In the United States Bankruptcy Court
for the
Southern District of Georgia
Savannah Division

In the matter of:	)	
	)	Adversary Proceeding
KENT C. POTTER	)	
(Chapter 7 Case 95-20049)	)	Number 95-2014
	)	
Debtor	)	
	)	
	)	
	)	
SOUTHEASTERN BANK	)	
	)	
Plaintiff	)	
	)	
	)	
	)	
v.	)	
	)	
KENT C. POTTER	)	
	)	
Defendant	)	

MOTION FOR RECONSIDERATION

In the above Motion, Defendant/Debtor, Kent C. Potter, asserts that this Court's previous Order of February 5, 1996, is in error principally because the Court misconstrued the application of 11 U.S.C. Section 523(a)(6). In pertinent part, 11 U.S.C.

Section 523(a)(6) states as follows,

> (a) A discharge under section 727 . . . of this title does not discharge an individual debtor from any debt--
>
> (6) for willful and malicious injury by the debtor to another entity or to the property of another entity;

11 U.S.C. § 523(a)(6). This section provides that a bankruptcy discharge will not discharge an individual debtor "for willful and malicious injury by the debtor to another entity or to the property of another entity." In the context of the Section 523(a)(6) exception to discharge, the Eleventh Circuit Court of Appeals has held that "willful" means intentional or deliberate and that "malice" can be established by a finding of implied or constructive malice. *See* Chrysler Credit Corp. v. Rebhan, 842 F.2d 1257, 1263 (11th Cir.1988); In re Ikner, 883 F.2d 986, 991 (11th Cir.1989); In re Forbes, 186 B.R. 764, 768 (debtor cannot sell the property in which another has a security interest and claim lack of willfulness and malice when the debtor should have known that the unauthorized sale of the property would destroy the creditor's security interest); *see also* Matter of Touchstone, 149 B.R. 721, 726 (Bankr.S.D.Fla. 1993)(constructive or implied malice is sufficient to satisfy the malice requirement of 11 U.S.C. Section 523(a)(6); In re Greene, 150 B.R. 282 (Bankr.S.D.Fla. 1993)).

On December 7, 1995, this Court held an adversary trial and pursuant to Bankruptcy Rule 7052 made specific findings of fact and conclusions of law. *See* In re

Potter, Adv. Proc. No. 95-2014, Ch. 7 Case No. 95-20049, slip op. at 2-10 (Bankr.S.D.Ga., Feb. 5, 1996)(Davis, J.). As a result of that Order, this Court excepted from discharge $20,362.50 of loan proceeds that, in accordance with the Debtor's representations and supporting loan documentation, were to be used only for the purchase of new equipment and, instead, were converted to sustain the business' day to day operations. Specifically, Debtor applied the money towards employees' salaries, taxes owed, and the monthly payments of the loan with Southeastern Bank. In this Motion for Reconsideration, Debtor makes the following contentions. First, he contends that his use of funds to continue his day to day operations were consistent with the intended use of the loan. In other words, Debtor asserts that since all of the proceeds were spent on a business purpose the injury which occurred was not substantially certain to flow from such act and, therefore, this Court may not infer malice. Second, Debtor argues that had he purchased the equipment and completed the renovations to the business his inability to pay Southeastern Bank would have occurred notwithstanding the "proper" use of the funds. Finally, Debtor contends that the parties developed course of dealing which broadened the scope of their written loan agreement to authorize the use of loan funds for general business purposes.

As interpreted by this Court, "willful and malicious injury includes willful and malicious conversion, which is the unauthorized exercise of ownership over goods belonging to another to the exclusion of the owner's rights." In re Wolfson, 56 F.3d 52, 53 (11 Cir.1995). Thus, the willful and malicious exception includes the conversion of

another's property, without his knowledge or consent, done intentionally and without justification or excuse. *See* Matter of Taylor, 187 B.R. 736, 738 (willfulness element not satisfied with regard to stolen property). Of course, a willful and malicious injury does not necessarily follow from every act of conversion without references to the encompassing circumstances. *See* Davis v. Aetna Acceptance Co., 293 U.S. 328, 332, 55 S.Ct. 151, 153, 79 L.Ed. 393 (1934). However, in the case before this Court, the facts clearly demonstrate that this debt must be excepted from discharge.

Debtor's testimony at trial reveal that he intentionally and knowingly used the loan proceeds for purposes other than purchasing equipment specified in the loan documents. It appears to be undisputed that Debtor's action arises to the level of willfulness. As mentioned previously malice can be established by implied or constructive malice if the plaintiff can demonstrate that the debtor knew of should have that known that his actions would cause financial harm to the plaintiff. *See* Ford Motor Credit Co. vs. Rose, 183 B.R. 742, 745 (Bankr.W.D.Va. 1995)(providing that to prove malice a plaintiff must demonstrate that "in light of the surrounding circumstances, the debtor knew or should have known that his acts would cause financial harm to the creditor"); In re Forbes, 186 B.R. at 768. Although this Court is mindful that a debtor's reckless conversion of property does not amount to a willful and malicious injury, in this instance Debtor's actions allow this Court to infer malice. Simply stated, Debtor never purchased most of the collateral listed in the loan documents. When applying for the loan, Debtor listed specific and specialized

collateral that he intended to acquire. The Bank loaned the money with the knowledge that it would receive a security interest in the purchased equipment. By not purchasing the equipment, Debtor, a sophisticated businessman who negotiated and clearly understood the loan agreement, should have known that an injury would be substantially certain to occur. Contrary to the Debtor's contention, the actual injury was not Southeastern Bank's inability to recover on its loan from the Debtor; instead, the injury was the loss of a security interest at the time of conversion. This creditor clearly did not agree to nor bargain for the unsecured loan which it received instantly upon conversion.

In the previous Order, this Court granted to the Debtor a discharge for an amount equal to all items purchased with the loan proceeds which subsequently were stolen out of Debtor's place of business. Although Debtor appeared to display a reckless disregard towards these items of collateral, Section 523(a)(6) does not except from discharge a debt incurred through recklessness. However, when the Debtor converted the loan proceeds by using them for purposes other than those specified in the loan document, Southeastern Bank was injured through the loss of its security and the Debtor should have known that this action would cause certain injury.

Debtor further contends that had he used the proceeds for their intended use he still would have been unable to repay the loan. However, this argument only supports the contention that the actual injury was not Debtor's inability to repay the loan and, instead, was

the loss of Southeastern Bank's security interest. Had Debtor purchased the necessary equipment, in the event of Debtor's financial failure Southeastern Bank would have been in a position to foreclose on its collateral and recover a substantial portion of the loan proceeds. The bottom line is that the Debtor intentionally converted an amount equal to $20,365.50 for his benefit and that of other creditors. Thus, this Court will infer malice and, since Debtor's action of converting loan proceeds amounts to an unauthorized use of another's property to the exclusion of the owner's rights, the debt shall be excepted from discharge pursuant to Section 523(a)(6).

In the alternative, Debtor contends that Southeastern Bank's course of conduct prevents the application of Section 523(a)(6). In support of his position, Debtor cites In re Wolfson, 56 F.3d at 53. In Wolfson, the Eleventh Circuit Court of Appeals held that "[t]here may be an honest, but mistaken belief, *engendered by a course of dealing*, that powers have been enlarged or incapacities removed. In these and like cases, what is done is a tort, but not a wilful [*sic*] and malicious one." Id. at 53 (*citing* Davis vs. Aetna Acceptance Co., 293 U.S. at 332). However, unlike the present case, the creditor in Wolfson "knowingly acquiesced in Wolfson's business practices, and took no steps to protect its collateral." Id. at 53. Specifically, the Wolfson creditor, Equine Capital Corporation ("ECC"), received monthly financial reports which included an accounting of all sale proceeds. Moreover, "ECC knew that the Farm placed its proceeds into a general business account out of which it paid ordinary business expenses, and knew also which of the loan

collateral the Farm had sold during the month." Id. at 53. Debtor asserts that because Southeastern Bank's representative inspected the premises and felt secure enough not to call in the loan his failure to take reasonable steps to protect the Bank's collateral prevents the application of Section 523(a)(6). Southeastern Bank's acquiescence only demonstrates an intent to permit the creditor an extended period within which to acquire and install the necessary equipment. Testimony reveals that Southeastern Bank's representative, William Gay, was unaware of Debtor's decision to use the loan proceeds for normal business expenses and did not expressly or implicitly consent to this practice.[1]

A course of dealing exception to Section 523(a)(6) should not be interpreted so broadly that a creditor's failure to take every precaution renders the debt dischargeable. The exception applies to instances where an extended course of dealing changes the terms and scope of a contract. Pursuant to Section 523(a)(6), a debtor may rely on the exception only if the evidence supports an inference that a creditor through his knowledge and actions or lack thereof implicitly waives his rights in the collateral. In this matter, testimony revealed that Southeastern Bank was unaware of Debtor's conversion and took reasonable steps to protect its collateral through periodic inspections.[2] Therefore, I find that the course of dealing did not alter the requirements of the contract and pursuant to Section 523(a)(6)

[1] It should be noted that although the Bank on one occasion extended additional credit to the Debtor, that loan was secured by other and unrelated collateral making that fact immaterial to the present matter.

[2] Testimony also revealed that Southeastern Bank suggested disbursing the loan proceeds in periodic draws; however, Debtor insisted that a lump sum payment was necessary. By arguing today that Southeastern Bank should have policed its collateral in a more efficient manner, Debtor requests this Court to sanction Southeastern Bank for actions urged by the Debtor himself.

this debt shall be excepted from discharge.

ORDER

Pursuant to the foregoing Findings of Fact and Conclusions of Law, IT IS THE ORDER OF THIS COURT that the obligation of Debtor, Kent C. Potter, to Plaintiff, Southeastern Bank, in the approximate amount of $20,362.50 is excepted from discharge and the Motion for Reconsideration is hereby DENIED.

Lamar W. Davis, Jr.
United States Bankruptcy Judge

Dated at Savannah, Georgia

This ___ day of May, 1996.